UNIVERSITY OF CAPE COAST

GROUP 3 ASSIGNMENT

MERCANTILISM

INTRODUCTION

The term mercantilism was coined by Mirabeau in1763 to describe that loose system of economic ideas that seemed to dominate economic discourse form the beginning of the sixteenth century to almost the end of the eighteenth century. Mercantilist writers were a disparate group. Most of them were merchants and many simply espoused their own interests. Even though it was international, that is , in England, Holland, France and Germany, on the whole there was less consistency and continuity among mercantilist than among the Scholastics of the previous age. Lack of cohesion can be attributed in large measure to the absence of common analytical tools that could be shared and passed on to a generation of successors. Furthermore, communication among mercantilists was poor and nonexistent, in contrast to the strong network of interrelations among modern economists.

Even though, mercantilist writings do not exhibit a thorough unification and conformity of all economic ideas, they do exhibit some common tenets, doctrines and mode of argument. The mercantilist thought developed in Western European countries and is found the emergence of commercial capitalism right to the latter half of eighteenth century.

Mercantilism is closely associated with trade and commercial activities of an economy. We may state that the framework for mercantilist approach was conditioned by two things, namely, the perpetual neediness of the government and the effect on the European economic conditions occasioned by the discoveries of the precious metals in the New World and the inflow of the same.

Several economical and historical backgrounds laid the foundation of mercantilist ideas. Firstly, the social and economic side contributed significantly on the growth of mercantilist philosophy. Renaissance was the first. According to Edward Heimann (1945), 'renaissance marks a much deeper break in the history of the western world than is suggested by its name. The medieval conception of the world as a universal cosmos was shattered. The one empire gave way to a multiplicity of national territories and states.'' The rise of Protestantism was associated to development. This led to the weakening of loyal and blind obedience and gave way to more reasoned arguments

Secondly, there were changes on the economic and political front also. During this era, feudalism was slowly yielding place to commercial capitalism. Feudalism, with its economically, socially, and politically self-sufficient manors, was giving way to increasing trade, the growth of cities outside the manor, and the growth of the nation-state. Individual activity was less controlled by the custom and tradition of the feudal society and by the authority of the church. Production of goods for the market became more important, and land, labor, and capital began to be bought and sold in markets. This laid the groundwork for the Industrial Revolution.

On the political front, nation states were rising and the most powerful of them were acquiring colonies and spheres of influence. The authority and power of the Pope was questioned progressively Economic rivalry between nations were intensified. It is not surprising; then, that a body of doctrine evolved that superseded feudal concepts, promoted nationalism and gave new dignity and importance to the merchant, and justified a policy of economic and military expansion. It happened that every state had to depend on its own defensive strength and had to protect its interests in the foreign trade sphere also.

The economic theory of mercantilism was the work of merchant businessmen. However, throughout the mercantilistic period, both the quantity and the quality of economic literature grew. The mercantilistic literature from 1650 to 1750 was of distinctly higher quality; scattered throughout it are nearly all the analytical concepts on which Adam Smith based his Wealth of Nations, which was published in 1776.

The goal of economic activity, according to most mercantilists, was production not consumption, as classical economics would later have it. For the mercantilists, the wealth of the nation was not defined in terms of the sum of individual wealth. They advocated increasing the nation's wealth by simultaneously encouraging production, increasing exports, and holding down domestic consumption. Thus, the wealth of the nation rested on the poverty of the many. The social consequences were enormous. On the one hand, there was a gradual impoverishment of those classes, aristocratic and clerical, which lived on incomes which, being fixed by custom, adjusted extremely slowly to the fall in the value of money. On the other hand, there was an unprecedented enrichment of the mercantile class, who lived on 'profits upon alienation', namely, incomes derived from the difference between the buying and selling prices of goods, a type of profit that naturally increases with inflation.

The contents of mercantilism can be meaningfully analyzed and appreciated only in the context of the objectives for which mercantilism stood. Below are some elaborations on the various concepts.

BULLIONISM

Bullionism is an economic theory that defines wealth by the amount of precious metals owned. It is an early or primitive form of mercantilism. It was derived, in the 16th century, from the observation that the English state possessed large amounts of gold and silver, despite the fact that there was no mining of precious metals on English soil, because of its large trade surplus**.** Bullionism which is the monetary policy of mercantilism, called for national regulation of transactions in foreign exchange and in precious metals (bullion) in order to maintain a "favourable balance" in the home country.

Spain, with which the policy is most closely associated, was preeminent in developing a colonial empire and drew from the New World great quantities of gold and silver during the 16th and 17th centuries. Nations attributed Spain's greatness to its almost limitless supply of precious metals, which were thought to increase commerce and provide the sinews of war, for, with a full treasury, armies could be bought and a vigorous population could flourish. This led to the development in theory and practice of the idea of a favourable balance of trade that would increase the nation's supply of gold and silver money. Spain, however, in draining precious metals from its colonies and buying goods and services from other states, lost its treasure and failed to develop home industry. In the end Spain changed from the richest to one of the most impoverished European states.

Bullionism had dominated the opinions circulating in the European courts up to the end of the sixteenth century. It was characterized by the conviction that money, or gold, was the wealth. Now, there is obviously no doubt that money is wealth. The mistake, according to Smith, was the belief that it was the only form of wealth. However, it is doubtful that there have ever been economists who really thought in this way. Rather, there was a widespread opinion that treasure was the only type of wealth worth accumulating, an opinion which had more than a grain of truth from the point of view of the State, in an era in which wars were won with gold. This idea also accorded well with the merchant's point of view, for which money was capital and, actually, the only type of capital capable of increasing in value. In fact, it was clear to almost every economist of the period that money was a means of increasing wealth and power. Why many of the bullionists did not admit the birth of political economy was the idea that that means should be used to increase the welfare of people, the wealth of nations, as Smith claimed. But why should the State and the merchants have had to pursue such an objective?

In fact, the first bullionist economists, when they were not merchants, were administrators of the sovereign's private finances rather than civil servants; in other words, they were still concerned with a household economy. This was certainly true of the German cameralists, who worked at the Kammer, or treasury, of the sovereign; and the same was true for many of the Spanish bullionists. They had good reasons, therefore, to work towards rulers' private goals. The real mistake made by these economists, however, and the one which distinguishes them from the mercantilists of the following century, was in the methods they suggested for achieving these objectives. A wide circulation of money within the national borders was considered to guarantee an extensive tax base; therefore, the outflow of precious metals had to be prevented. The simplest way to do this was to prohibit the export of gold and silver, a method that was applied rigorously, sometimes even ferociously, in many countries. Another measure often adopted was that of raising the purchasing power of the foreign currencies by law within the national territory, so as to induce an inflow of money from abroad. Besides this, there were also attempts to force national companies to pay for imports with goods instead of money. Finally, a measure that was used above all in Spain was that of the 'balance of contracts': buying from each foreign country an amount of goods which did not exceed the amount exported to that country.

THE BULLIONIST CONTROVERSY

The Bullionist Controversy was not a clear-cut argument about a well-defined issue, but rather a series of overlapping debates about a number of related questions. These exchanges took place in Britain against the background of the wars which that country and a shifting coalition of allies fought against Revolutionary and Napoleonic France between 1792 and 1815, and of the peace that followed. They were always concerned with immediate policy problems; but their participants developed a remarkable series of insights into the general nature of a monetary economy that would provide foundations upon which economists could build for the next hundred years or so, as I shall try to show in this essay. In the opening stages of the wars precipitated by the French Revolution, France's armies experienced remarkable and unforeseen success, so much so that, by late 1797, among her enemies, only Britain remained a combatant. Early in that year, widespread rumours of an imminent French invasion - a small French force did in fact land on the coast of Wales - created enough consternation in Britain to provoke a run on the banks, to which the British government responded on February 27th by suspending, by Order in Council, the Bank of England's obligation to convert its notes into gold bullion on demand. This "temporary" suspension, was extended for a further month by legislation in May 1797, but was to last until 1821.1

The Monetary System in the 1790s

At this time, Britain, though nominally on a bimetallic standard, had been on a *de facto* gold standard since 1717, as a result of gold's mint price having been set too high in that year, at the culmination of a series of reforms to the coinage that had begun in 1696. The Bank of England had been founded in 1694 to create and manage a market for government debt, but, by the end of the 18th century, its status as the only joint-stock bank in England and Wales and its monopoly of note issue in the London area had given it a pivotal position in an already complex British banking system. In England and Wales, outside of London, the so-called "country banks", which were private partnerships, both issued notes and accepted deposits. The Scottish banking system was governed by a legal framework distinct from that in force in England and Wales, and consisted of a mixture of large chartered joint stock banks and smaller private partnerships which also issued notes and took deposits. Like the English country banks, however, the Scottish institutions, particularly the chartered joint-stock banks, held a substantial part of their reserves

in claims on deposit-taking private banks located in London. These, in turn, held reserves in the form of Bank of England liabilities, both notes and deposits, though at these time notes seem to have dominated. It is, therefore, possible to speak of a single British monetary system, centered on the Bank of England, which in turn held its own reserves mainly in the form of gold bullion. Ireland, however, had its own system at this time, centered on Dublin. British banking did not, of course, form quite so neat an inverted credit pyramid as this brief description might suggest. Bank of England notes, for example, circulated outside of London and were directly held by country banks, as indeed was a certain amount of gold bullion; and, to complicate matters further, a substantial amount of gold coin both circulated as currency and was held by banks. Nevertheless, both the export and melting of coin was forbidden, and the monetary system's reserves of gold bullion were heavily concentrated in the Bank of England. Though not widely recognized as such, this institution was thus Britain's *de facto* central bank, and the 1797 suspension of its obligation to convert its notes into bullion shifted the British monetary system from a commodity standard towards a flexible exchange rate. The actual transition was not an abrupt one, however, being complicated by the fact that, initially, illegal melting and export of coin, which continued to trade at par with Bank of England notes, limited the extent to which their price in terms of gold bullion could fall.

The State of Monetary Economics

All of this is easily grasped in the light of modern ways of thinking about monetary matters, but at the end of the eighteenth century, the development of monetary institutions was substantially ahead of that of monetary theory. David Hume (1752), perhaps building on the earlier and at that time unknown work of Richard Cantillon (first published in 1755), had already developed the basic properties of the quantity theory of money as it applied to a commodity money, and he had also worked out what was later called the "price-specie-flow" mechanism of the balance of payments. Hume had only a little to say about banking, but, in the *Wealth of Nations* (1776), Adam Smith provided an extensive account of the operations of a system of competitive note-issuing commercial banks against a background of specie-convertibility. Smith's analysis, however, was heavily conditioned by contemporary Scottish experience, and was limited to the case of a small price-level-taking open economy.

Thus, in 1797, monetary economics, at least as it existed in the English language, lacked both a theory of flexible exchange rates and a theory of central banking under either a commodity standard or flexible rates. In fact, during the Seven Years War (1756- 63) a Swedish literature had already made substantial headway with these questions, as Eagly (1968) Myhrman (1976), as well as Persson and Siven (1993) have shown, but there is no hard evidence that anyone in Britain was aware of the work in question, as opposed to the events which had generated it, at the time.3 Be that as it may, in the following quarter century, English Classical monetary economics acquired the above-mentioned and much needed components, and took on a shape that remains recognizable in the subject two hundred years later.

In hindsight, the Bullionist Controversy is usefully thought of as falling into three episodes. Two bouts of inflation generated intensive debate about their causes and remedies between about 1798 and 1803, and 1808 and 1811 respectively, while, after Napoleon's retreat from Moscow in 1812, the final phase of the discussion became concerned with the restoration of gold convertibility. I shall deal with these three episodes below, before concluding with a brief discussion of the Controversy's influence on subsequent debates.

The Controversy's First Phase

Any modern discussion of inflation would pay attention to the behaviour of one or more price index, but such data did not exist at the time of the Bullionist controversy. Even during the final

phase of the controversy, David Ricardo (1816) would write as follows: "It has indeed been said that we might judge of its [paper money's] value by its relation, not to one, but to the mass of commodities. If it should be conceded, which it cannot be, that the issuers of paper money would be willing to regulate the amount of their circulation by such a test, they would have no means of so doing it; for when we consider that commodities are continually varying in value, as compared with each other; and that when such variation takes place, it is impossible to ascertain which commodity is increased, which diminished in value, it must be allowed that such a test would be of no use whatever" (1816, p.59) Though, as Fetter (1965, pp.138-9) has noted, the concept of a price index was sporadically discussed during this period, it was not until 1863 that a usable version of such a device was produced and put to work by William Stanley Jevons. The data to which participants in the Bullionist controversy paid attention were the prices of specific, widely traded, commodities such as wheat, the price of sterling bills of exchange, notably in the financial centres of Hamburg and Amsterdam, both of which operated on the silver, rather than gold, standard, and, above all, the sterling price of gold bullion. Classical value theory, to which Ricardo (1817) was a major contributor, held that any commodity's "natural", that is long-run equilibrium, value was determined by cost of production; and it was also believed, not least by Ricardo, that the production costs of gold and silver were relatively stable. It is hardly surprising, therefore, that any tendency for the exchange rate on currencies which had remained convertible after 1797 to fall, or of the sterling price of gold bullion, into which Bank of England notes had been convertible before 1797, to rise, was treated by protagonists in the Bullionist controversy as evidence of inflation.

The Simple Bullionist Position

The years 1798-1801 saw all three of the above-mentioned indicators giving signs of trouble: agricultural prices rose, as did the price of gold bullion, while exchange rates fell. It is generally agreed that the publication in 1801 of Walter Boyd's *Letter to the Right Honourable William Pitt on the Influence of the Stoppage of Issue in Specie at the Bank of England on the Prices of Provisions and Other Commodities* marked the real beginning of the Bullionist Controversy. Boyd had a personal axe to grind, his company, Boyd, Benfield and Co. having recently failed in the wake of the government's refusal to employ it as contractor for a major loan in 1799; and his analysis was rather crude. Nevertheless, his pamphlet set out the essentials of what in due course came to be called the Bullionist position: namely, that rising prices and the falling exchanges had a common source in an over-issue of Bank of England notes, that this had been undertaken to buy government debt, and that it would have been impossible had the Bank not recently been relieved of its obligations to convert its liabilities into gold on demand. In the subsequent debate, this position, whose basis in the quantity theory of money is readily evident, was taken up by, among others, John Wheatley (1803), perhaps, the leading exponent of the so-called extreme-Bullionist position in the first phase of the controversy.

Anti-Bullionism

The Bank of England did not lack for defenders, and among them there would in due course develop an "anti-bullionist" position, whose features were given different weights by different protagonists, but included the following propositions. First, rising agricultural prices were the result of poor harvests, and the falling exchange rate was both a by-product of the extra food imports that these had generated, and a consequence of an outflow of funds needed to pay subsidies to Britain's allies in the war against France. In the latter suggestion lies one important origin of the Classical analysis of what was, in due course, to be called the "transfer problem", while the former is a prototype of many a "real shock – cost push" explanation of inflation. Secondly, to the extent that an over-issue of notes had anything to do with rising prices, the fault

lay with the country bank note issue, which could fluctuate significantly and independently of that of the Bank of England. Thirdly, and at the very heart of the anti-bullionist position, there lay a precept for the proper conduct of monetary policy which Lloyd Mints (1945) would, a century and a half later, call the *Real Bills Doctrine.*

SOME BULLIONISTS

Thomas Milles (1550–1627) and others recommended increasing exports in order to get a trade surplus, converting it into precious metals and hindering the drain of money and precious metal to other countries. Although England practiced the interdiction of exportation of £ or precious metals at about 1600, Milles desired to return to staple ports in order to force merchants from abroad to use their assets to buy English goods and to prevent them from transferring gold or silver from England homewards. But Milles may have been viewed as one who did not have any valuable words to say on the subject, as one of his contemporaries wrote: "Milles was so much out of step with the time that his pamphlets had little influence".

Gerard de Malynes (1586–1641), another bullionist, published a book called *A Treatise of the Canker of England's Common Wealth*, in which he asserted that the exchange of foreign currency had been a trade of value rather than exchanging the weight of metals. Therefore the unfair exchanging of precious metals by bankers and money changers, would result in the deficit of English balance of trade. In order to ban the flow of exchange rates, he demanded the strict fixing of exchange rates for coins, only by the concentration of precious metals and weights and for strict regulation and monitoring of foreign trade. But de Malynes did not convince his contemporaries "that the cambists were responsible for gold outflow or to elicit enthusiasm for a monopoly sale of exchange, par pro pari, by the royal exchanger". He did, however, succeed in stirring up one of the first economic controversies, and Edward Misselden opposed him in 1623 in his book *The Circle of Commerce: Or, the Balance of Trade*.

CRITICISM

The real mistake made by these economists, however, and the one which distinguishes them from the mercantilists of the following century, was in the methods they suggested for achieving these objectives. A wide circulation of money within the national borders was considered to guarantee an extensive tax base; therefore, the outflow of precious metals had to be prevented. The simplest way to do this was to prohibit the export of gold and silver, a method that was applied rigorously, sometimes even ferociously, in many countries. Another measure often adopted was that of raising the purchasing power of the foreign currencies by law within the national territory, so as to induce an inflow of money from abroad. Besides this, there were also attempts to force national companies to pay for imports with goods instead of money. Finally, a measure that was used above all in Spain was that of the 'balance of contracts': buying from each foreign country an amount of goods which did not exceed the amount exported to that country.

Another bullionist 'mistake' was the tendency to seek the causes of a systematic outflow of precious metals solely in monetary factors, namely, in the deviations of exchange rates from the parity determined by the metallic content. Such deviations were attributed to illegal behaviour, forgery, and manipulations by bankers and merchants. But the Crown also, often and willingly, resorted to illegal monetary techniques, such as 'clipping', i.e. reducing the metallic content of the currency in relation to face values, or 'raising', i.e. increasing, by means of a proclamation, the official value of the currency in relation to its metallic content. There were many learned investigations in this field, some of which led to the formulation of an important

economic law, ‘Gresham’s Law’, according to which bad money drives out good. If, in a country, two types of currency circulate which have the same nominal value but different intrinsic values (because one of the two has a lower content of precious metal, because it is a forgery or worn), the public will tend to use the bad money for internal payments. The good will be hoarded, melted down, or used for international payments, and will therefore disappear from circulation. In regard to the naming of this law, it is worth pointing out that in 1857 its discovery was attributed to Thomas Gresham by Henry McLeod, who later the birth of political economy changed his mind and called it the ‘Oresme–Copernicus–Gresham Law’. Gresham provided a precise formulation of the law in a letter to Queen Elizabeth I. Today it is known that the first formulation goes back to 1519 and is owed to Nicholas Copernicus, even if some hints of it can be found in Nicolas Oresme.

BALANCE OF TRADE DOCTRINE

The mercantilists proceeded on the assumption that the total wealth of the world was fixed. Using the same assumption, the scholastics had reasoned that when trade took place between individuals, the gain of one was necessarily the loss of another. The mercantilists applied this reasoning to trade between nations, concluding that any increase in the wealth and economic power of one nation occurred at the expense of other nations. Thus, the mercantilists emphasized international trade as a means of increasing the wealth and power of a nation and, in particular, focused on the balance of trade between nations.

Balance of trade which is sometimes symbolized as (NX) is described as the difference between the monetary value of export and import of output in an economy over a certain period. It could also been seen as the relationship between the nation’s import and exports. When the balance has a positive indication, it is termed a trade surplus, that is, if it consists of exporting more than is imported and a trade deficit or a trade gap if the reverse is the case. The Balance of trade encompasses the activity of exports and imports. It is expected that a country who does more of exports than imports stands a big chance of enjoying a balance of trade surplus in its economy more than its counterpart who does the opposite.

Mercantilism is the economic doctrine in which government control of foreign trade is of paramount importance for ensuring the prosperity and military security of the state. In particular, it demands a positive balance of trade. Its main purpose was to increase a nation’s wealth by imposing government regulation concerning all of the nation’s commercial interest. It was believed that national strength could be maximized by limiting imports via tariffs and maximizing export. It encouraged more exports and discouraged imports so as to gain trade balance advantage that would eventually culminate into trade surplus for the nation. In fact, this has been the common practice of the western world in which they were able to gain trade superiority over their colonies and third world countries

It must be noted that mercantilist thinking was conditioned by the hypothesis that total world resources were limited. This led to a static element in their reasoning in two forms. They believed that a country could again only at the cost of another and they were interested in making their country relatively stronger that their neighbours. Therefore, in order to secure a surplus balance of trade, it was imperative that only exports should be more in volume but that export of higher international value should be preferred to exports of lower value. Thus the export of raw materials was not favoured. It was advocated that to the extent possible efforts should be made to process raw materials into finished goods for exporting. On the other hand, imports should be confined, more or less, to the raw materials which should be preferred to manufacturer. This was because raw materials were processed into finished goods and re-exported at higher prices.

Trade Surplus can be defined as a positive balance of trade where a country's export exceeds its imports. A trade surplus represents a net inflow of domestic currency from foreign markets and is the opposite of a trade deficit, which would represent a net outflow.

PAPER MONEY MERCANTILISM

Mercantilism and Inflation

The Bank of England

The post medieval state acquired most of its eagerly sought revenues by taxation. But the state has always been attracted by the idea of creating its own money in addition to plundering directly the wealth of its subjects. Before the invention of paper money, however, the state was limited in money creation to occasional debasements of the coinage, of which it had long managed to secure a compulsory monopoly. For debasement was a one-shot process, and could not be used, as the state would always like, to create money continually and feed it into state coffers for use in building palaces, pyramids, and other consumption goods for the state apparatus and its power elite.

The highly inflationary instrument of government paper money was first discovered in the Western world in French Quebec in 1685. Monsieur Meules, the governing intendant of Quebec, pressed as usual for funds, decided to augment them by dividing some playing cards into quarters, marking them with various denominations of French currency, and then using them to pay for wages and materials. This card money, later redeemed in actual specie, soon became repeatedly issued paper tickets.

The first more familiar form of government paper began five years later, in 1690, in the British colony of Massachusetts. Massachusetts had sent soldiers on one of their customary plunder expeditions against prosperous French Quebec, but this time had been beaten back. The disgruntled Massachusetts soldiery was even more irritated by the fact that their pay had always come out of their individual shares of French booty sold at auction, but that now there was no money for them to collect.

The Massachusetts government, beset by demands for payment of their salary by a mutinous soldiery, was not able to borrow the money from Boston merchants, who shrewdly considered its credit rating unworthy. Finally, Massachusetts hit upon the expedient of issuing 7,000 pounds in paper notes, supposed to be redeemable in specie in a few years. Inevitably, the few years began to stretch out on the horizon, and the government, delighted with this newfound way of acquiring seemingly costless revenue, poured on the printing presses and quickly issued 40,000 more paper pounds. Fatefully, paper money had been born.

It was to be two decades before the French government, under the influence of the fanatically inflationist Scottish theoretician John Law, turned on the taps of paper-money inflation at home. The English government turned instead to a more subtle device for accomplishing the same objective: the creation of a new institution in history — a central bank.

The key to English history in the 17th and 18th centuries is the perpetual wars in which the English state was continually engaged. Wars meant gigantic financial requirements for the Crown. Before the advent of the central bank and government paper, any government not willing to tax the country for the full cost of war relied on an ever more extensive public debt. But if the public debt continues to rise, and taxes are not increased, something has to give, and the piper must be paid.

Before the 17th century, loans were generally made by banks, and "banks" were institutions in which capitalists lent out funds that they had saved. There was no deposit banking; merchants who wanted a safe place to keep their surplus gold deposited it in the King's Mint in the Tower of London — an institution accustomed to storing gold. This habit, however, proved highly costly, for King Charles I, needing money shortly before the outbreak of the civil war in 1638, simply confiscated the huge sum of 200,000 pounds in gold stored at the mint — announcing it to be a "loan" from the depositors. Understandably shaken by their experience, merchants began depositing their gold in the coffers of private goldsmiths, who were also accustomed to the storing and safekeeping of precious metals. Soon, goldsmiths' notes began to function as private bank notes, the product of deposit banking.

The Restoration government soon needed to raise a great deal of money for wars with the Dutch. Taxes were greatly increased, and the Crown borrowed extensively from the goldsmiths. In late 1671, King Charles II asked the bankers for further large loans to finance a new fleet. Upon the goldsmiths' refusal, the king proclaimed, on 5 January 1672, a "stop of the Exchequer," that is, a willful refusal to pay any interest or principal on much of the outstanding public debt. Some of the "stopped" debt was owed by the government to suppliers and pensioners, but the vast bulk was held by the victimized goldsmiths. Indeed, of the total stopped debt of 1.21 million pounds, 1.17 million was owned by the goldsmiths.

Five years later, in 1677, the Crown grudgingly began paying interest on the stopped debt. But by the time of the eviction of James II in 1688, only a little over 6 years of interest had been paid out of the 12 years' debt. Furthermore, the interest was paid at the arbitrary rate of 6 percent, even though the king had originally contracted to pay interest at rates ranging from 8 to 10 percent.

The goldsmiths were even more intensively thwarted by the new government of William and Mary, ushered in by the Glorious Revolution of 1688. The new regime simply refused to pay any interest or principal on the stopped debt. The hapless creditors took the case to court, but while the judges agreed in principle with the creditors' case, their decision was overruled by the Lord Keeper, who candidly argued that the government's financial problems must take precedence over justice and property right.

The upshot of the "stop" was that the House of Commons settled the affair in 1701, decreeing that half of the capital sum of the debt be simply wiped out — and that interest on the other half begin to be paid at the end of 1705, at the remarkable rate of 3 percent. Even that low rate was later cut to 2.5 percent.

The consequences of this declaration of bankruptcy by the king were as could be predicted: public credit was severely impaired, and financial disaster struck for the goldsmiths, whose notes were no longer acceptable to the public, and for their depositors. Most of the leading goldsmith-creditors went bankrupt by the 1680s, and many ended their lives in debtors' prison. Private deposit banking had received a crippling blow, a blow which would only be overcome by the creation of a central bank.

The stop of the exchequer, then, coming only two decades after the confiscation of the gold at the Mint, managed virtually to destroy at one blow private-deposit banking and the government's credit. But endless wars with France were now looming, and where would government get the money to finance them?

Salvation came in the form of a group of promoters, headed by the Scot William Paterson. Paterson approached a special committee of the House of Commons formed in early 1693 to study the problem of raising funds, and proposed a remarkable new scheme. In return for a set of

important special privileges from the state, Paterson and his group would form the Bank of England, which would issue new notes, most of which would be used to finance the government's deficit. In short, since there were not enough private savers willing to finance the deficit, Paterson and company were graciously willing to buy interest-bearing government bonds, to be paid for by newly created bank notes, carrying a raft of special privileges with them. As soon as Parliament duly chartered the Bank of England in 1694, King William himself and various MPs rushed to become shareholders of this new money-creating bonanza.

"Whenever the central bank inflated itself into financial trouble, the government stood ready to allow it to suspend specie payments."

William Paterson urged the English government to grant Bank of England notes legal-tender power, but this was going too far, even for the British Crown. But Parliament did give the bank the advantage of holding deposits of all government funds.

The new institution of government-privileged central banking soon demonstrated its inflationary power. The Bank of England quickly issued the enormous sum of 760,000 pounds, most of which were used to buy government debt. This issue had an immediate and substantial inflationary impact, and in two short years, the Bank of England was insolvent after a bank run, an insolvency gleefully abetted by its competitors, the private goldsmiths, who were happy to return to it the swollen Bank of England notes for redemption of specie.

At this point, the English government made a fateful decision: in May 1696, it simply allowed the bank to "suspend specie payment." In short, it allowed the bank to refuse indefinitely to pay its contractual obligations to redeem its notes in gold, while at the same time continuing blithely in operation, issuing notes and enforcing payments upon its own debtors. The bank resumed specie payments two years later, but this act set a precedent for British and American banking from that point on. Whenever the bank inflated itself into financial trouble, the government stood ready to allow it to suspend specie payments. During the last wars with France, in the late 18th and early 19th century, the bank was allowed to suspend payments for two decades.

The same year, 1696, the Bank of England had another scare: the specter of competition. A Tory financial group tried to establish a national land bank, to compete with the Whig-dominated central bank. The attempt failed, but the Bank of England moved quickly to induce Parliament, in 1697, to pass a law prohibiting any new corporate bank from being established in England. Any new bank would have to be either proprietary or owned by a partnership, thereby severely limiting the extent of competition with the bank.

Furthermore, counterfeiting of Bank of England notes was now made punishable by death. In 1708, Parliament followed up this set of privileges by another crucial one: it now became unlawful for any corporate bank other than the Bank of England, and for any bank partnership over six persons, to issue notes. And, moreover, incorporated banks and partnerships over six were also prohibited from making any short-term loans. The Bank of England now only had to compete with tiny banks.

Thus, by the end of the 17th century, the states of Western Europe, particularly England and France, had discovered a grand new route toward the aggrandizement of state power: revenue through inflationary creation of paper money, either by government or, more subtly, by a privileged, monopolistic, central bank.

In England, private banks of deposit were inspired to proliferate (especially checking accounts) under this umbrella, and the government was at last able to expand the public debt to fight its endless wars; during the French war of 1702–13, for example it was able to finance 31 percent of its budget via public debt.

Paper Money Inflation

Massachusetts has the dubious distinction of having promulgated the first governmental paper money in the history of the Western world—indeed, in the history of the entire world outside of China. The fateful issue was made in 1690, to pay for a plunder expedition against French Canada that had failed drastically. But even before this, the leading men of the colony were busy proposing paper money schemes. The Rev. John Woodbridge, greatly influenced by William Potter's proposals for an inflationary land bank, proposed one of his own, as did Governor John Winthrop, Jr., of Connecticut. Captain John Blackwell proposed a land bank in 1686, the notes of which would be legal tender in the colony, and such wealthy leaders of the colony as Joseph Dudley, William Stoughton, and Wait Winthrop were prominently associated with the plan.

The most famous of the inflationary land-bank schemes was the Massachusetts Land Bank of 1740, which has generally been limned in neo-Marxist terms as the creation of the mass of poor farmer-debtors over the opposition of wealthy merchant-creditors of Boston. In actuality, its founder, John Colman, was a prominent Boston merchant and real-estate speculator; and its other supporters had similar interests—*as did* the leading opponents, who were also Boston businessmen. The difference is that the advocates had generally been receivers of land grants from the Massachusetts government, and desired inflation to raise the value of their speculatively-held land claims." Once again—a typically mercantilist project.

As mercantilism gave way to industrial production and export the late 18th and early 19th centuries, paper money and bank notes came into being and became widespread. The bulk of this money consisted not of gold or silver *per se* but of *fiduciary money* -promises to pay specified amounts of gold and silver. Individuals or companies initially issued such promissory notes as bank notes or as the transferable book entries that came to be called deposits, but gradually the state assumed a role in such matters. Moreover, the small step to fiat paper money -notes that are issued on the "fiat" of the sovereign and specified to be so many pounds or dollars or francs or yen etc., which are deemed to be legal tender but are not promises to pay something else- was rapidly taken. Thus, this crucial move from fiduciary paper money (promising to pay gold or silver) to *fiat paper money* (notes issued on the "fiat" of the sovereign that are deemed legal tender but are not promises to pay something else) is of paramount importance in understanding the role, influence and intentions of these powerful private organizations –central banks- in the affairs of this world.

Fiat is a legally binding command or decision entered on the court record, as if issued by a court or judge. In short, fiat is a decree and in regards to the medium of exchange, fiat money is what governments declare to be legal tender although it cannot be converted into standard specie i.e. exchanged for coinage or metal money usually gold and silver.

David Ricardo (1772-1823) the English economist of Jewish origin argued that the laws of supply and demand should operate in a free market, explained that a paper currency (Representative or Fiat Money) is one in which the whole value has been appropriated as Seigniorage (the charge by a government for coining bullion). Moreover, the cost of keeping a stock of valuable money is obviated while state authority supports the new instrument of exchange. What is important to appreciate here is that although a government can issue a paper currency, it is not within its power to dictate its value. This value is in the domain of the markets and especially of a principle called quantity theory wherein the inevitable decline in value of a fiat money ensues when issue passes a definite point. Common-sense and empirical experience suggests that the only effective mode of preventing depreciation of a nation's currency is by fixing the amount of paper money to that of the metallic money previously in circulation. Leaving the use of the paper currency optional by making it convertible into coin at the behest of

the holder is the easiest way to accomplish this is. By such an expedient the amount of paper money in circulation is thus automatically fixed by the action of the community.

A great disadvantage in this arrangement is the necessity of keeping an adequate reserve of standard specie (coinage) to meet actual and prospective demands. Ideally, the whole amount of paper issue (fiat money) should be covered by an equal value of metal (gold and/or silver). Unfortunately this ideal was never practiced long by governments, especially at times of pressure, when they succumbed to the temptation to render the notes inconvertible. That is, reducing their reserves to an inadequate amount and then escaping the difficulty by refusing to pay metal coin for paper notes. This devious stratagem is at the crux of government dealings with paper money: it is in essence the history of inconvertibility. Government interference in monetary matters and the loss that follows from a disturbance of the standard used in ordinary payments can be summarized thus:

-Injustice inflicted on creditors by being paid in a much lower standard than that in which they lent;

-Fluctuations in the value of money causing disturbance to trade, both domestic and foreign,

-Fall in the real wages of the working classes due to the slower rise of money wages in contrast with the quicker movement of the prices of commodities;

-Perturbation in dealings in the international money market due to exchange rate fluctuations**.**

Representative money arose in medieval times out of the demands of credit whereby a claim could be expressed and transferred by a document that could be used for facilitating exchanges. However, the rigid practice of early law hindered the extensive use of this convenient device. This radically changed in the late 18th and early 19th centuries when the coining of credit was made easy by the flourishing banking system when bank notes come into use and whose creditworthiness rests on the repute of the issuer and not on the fiat of the state. The burgeoning banking system was a network of privately owned institutions from which arose several banks that became pre-eminent and would dominate not only the world of finance but also the world itself. These very private and immensely powerful institutions are often called central banks and are crucial to the present monetary system.

With the ascendancy of central banks the two distinct forms of representative money –that issued by private banks and that issued by governments- became mixed. This was because the nominal control exercised over banks by government and to the very important fact that ban central banks were in many cases the agents by which what was virtually state money was issued e.g. the Dollar bank note (Federal Reserve Note) issued by the private bank called the Federal Reserve System. A fundamental difference between the two was that bank money enters the economy through the ordinary system of granting credit while government money enters through use in the purchase of commodities and the hire of services. These differences lead to bank money returning in a short time while government money remains in circulation and displaces metallic currency. The first large-scale issue of paper money was in France in the early 18th century, an idea the government extended in the form of assignats from 1789 to 1796.

CONTRIBUTIONS BY INDIVIDUAL THINKERS

1. **Antonio Serra**

Antonio Serra was an Italian and the first mercantilist writer giving a systematic version of mercantilist doctrine in his book he wrote in 1613, "*Breve trattato delle cause che possono far abbondare li regni d'oro et d'argento, dove non somo miniere, con applicanzione al Regno di Nalopi"* which is translated as Brief Treatise On The Causes Which Can Make Gold And Silver Abundant, Where There Are No Mines, With Application To The Kingdom Of Naples.

Marc Antonio de Santis' another author, in his book mentioned that the country s' rate of exchange was too high and that was keeping the money out. Marc on this basis advocated a regulation of the exchange to keep it down. Serra wrote his book to refute this contention and also brought in the wider question of national wealth. To him either a country should have its own mines or there should be other factors which enable a country to acquire these metals and these factors are termed ***Collateral factors***. These factors can further be divided into two;

a) ***Particular factors:*** These factors applied to only specific countries. He explained that a country whose surplus of products is in excess of need can transport them to countries where they are lacking or people could come from these countries to buy them leading to gold and silver being brought in. The geographical location of a trading area may also be of an advantage.
b) ***Common factors:*** These were those factors which could apply to any country. Four causes were identified;
    i. Quality of industry
    ii. Quality of population
    iii. Extensive trading operation
    iv. Regulations of the sovereign

Serra prefers industry to agriculture because there is greater certainty of profit in industry (acquiring silver and gold). Agricultural profit is not dependent on man's effort alone but also on some uncontrollable factors which includes the weather, varying needs of the land and the perishability nature of the goods which makes it difficult to expand trade.

Furthermore Serra explained the above factors and concluded that it was scarcity of foreign exchange which was causing high exchange rate and the only remedy is to have a surplus balance of trade so that when exported it will return with a profit to have abundant money in the country concern.

2. **Jean Bodin**

Bodin was a French lawyer (1530-1596). He wrote a number of books of which *Republique* and *Discourse of the Common Weal* is inclusive. An important contribution of his was in the field of understanding inflationary rise in prices which he made in his *Response*. It was being argued that prices were rising because of the debasement of the gold coin which was not solely the cause in the case of Bodine. He mentioned that the high prices can be challenged to five causes;

i. Abundance of gold and silver in the Kingdom
ii. Monopoly power
iii. Scarcity caused by export and waste
iv. Pleasure of Kings and great Lords to increase prices
v. Price of money

He pointed out that an all-round increase in prices is caused by an addition to money supply. France had increased in production and foreign trade which has led to the selling of its products to foreigners and getting specie in return.

Sir Josiah Child (1630-1699)

He favored a surplus balance of trade and supported an export of specie if it could result in a greater eventual inflow of it. To him international trade could not be unidirectional and some imports were bound to be there. Like Thomas Mun who also contributed to Mercantilism, he also insisted that a nation should direct its attention to the general rather than particular trade balance. Sir Child's main contribution, however, was in terms of the relationships between rate of interest

and flourishing trade and commerce. He believed that a low rate of interest encouraged expansion of trade and therefore strongly advocated for it. He supported his argument by stressing that Holland was ahead of England in trade primary on the account of the low rate of interest there. Child developed a theory of colonial economy and linked it to argument employment at home. Colonialism implied immigration from the home country which in itself was bad. But Child found out that in some cases this emigration might also create additional demand abroad for imports from the home country in which case home workers could be employed more beneficially. Thus the usefulness or otherwise of colonies depend upon the nature of individual colonies.

Sir John Law (1671-1729)

Sir John Law in his *Money and Trade Considered; With a Proposal for Supplying the Nation With Money* (1705) supported the view that an abundance of money was helpful to the trade of commerce. He submitted a plan for a note-issuing bank which was similar to the plan by William Paterson (1658-1719). Law's plan was tried in France but after some initial help to the economy it failed on account on there be no limit to the issuing of notes. In England, on the other hand, the scheme of note- issuing bank resulted in the establishment of Bank of England with limited security-backed issue and it was a success.

Thomas Mun (1571-1641)

He was a prominent British mercantilist writer Book IV of Adam Smith's *Wealth of Nations* (1776) is largely a refutation of mercantilistic theory and policy; in it, Smith quotes Mun as a leading mercantilist. Mun (1571-1641) was a director of the East India Company, which had been criticized for two things that some writers found undesirable:

(1) England imported more from India than it exported, and

(2) England sent precious metals to India to pay for imports.

Mun was a typical mercantilist—a proponent of governmental policies that benefited a particular business interest. Mun's first book, *A Discourse of Trade from England unto the East Indies* (1621); it defended the East India Company against these charges in a partisan manner. His second book, *England's Treasure by Forraign Trade*, was produced in 1628 and was published posthumously in 1664 by his son. The book had several editions, and its popularity was evidently the reason Smith chose it for rebuttal. It is often said that Mun's 1664 book is the classic of English mercantilistic literature.

American students are indirectly informed about mercantilistic theory and practice because of their awareness of the history of the American colonies. English policy was designed to keep the colonies a raw material-exporting economy that was dependent on England for manufactured goods.

Mun asserted in the title of his book that England's treasure was gained by foreign trade. His thinking was typically mercantilistic in that he confused the wealth of a nation with its stock of precious metals and therefore argued for a favorable balance of trade and an inflow of gold and silver to settle the trade balance. He believed that government should regulate foreign trade to achieve a favorable balance, encourage importation of cheap raw materials, encourage exportation of manufactured goods, enact protective tariffs on imported manufactured goods, and take other measures to increase population and keep wages low and competitive.

Mun presented these mercantilistic ideas but refuted some of the cruder mercantilistic notions that embodied criticisms of the East India Company. He pointed out that even though a favorable balance of trade with all nations was desirable and an outflow of precious metals to all nations was undesirable, the unfavorable balance of trade with and export of precious metals to India

was beneficial to England in that such practices enlarged its trade balances with all nations and, thereby, its inflow of gold and silver. By the time the last edition of Mun's famous book was published in 1755, many of the more perceptive mercantilists were seeing the serious errors of the mercantilistic paradigm. These liberal mercantilists were beginning to articulate the intellectual foundation for Smith's Wealth of Nations.

GENERAL PHILOSOPHY OF MERCANTILISM

Mercantilism was a sixteenth-century economic philosophy that maintained that a country's wealth was measured by its holdings of gold and silver (Mahoney, Trigg, Griffin, & Pustay, 1998). This required the countries to maximise the difference between its exports and imports by promoting exports and discouraging imports. The logic was transparent to sixteenth-century policy makers-if foreigners buy more goods from you than you buy from them, then the foreigners have to pay you the difference in gold and silver, enabling you to amass more treasure. With the treasure acquired the realm could build greater armies and navies and hence expand the nation's global influence.

Politically, mercantilism was popular with many manufactures and their workers. Export-oriented manufacturers favoured mercantilist trade policies, such as those giving subsidies or tax rebates, which stimulated their sales to foreigners. Domestic manufacturers threatened by foreign imports endorsed mercantilist trade policies, such as those imposing tariffs or quotas, which protected them from foreign competition (Mahoney, Trigg, Griffin, & Pustay, 1998). Most members of society are hurt by such policies. Government subsidies of exports for selected industries are paid for by taxpayers.

Mercantilist terminology is still used today, an example when television commentators and newspaper headlines report that a country suffered an unfavourable balance of trade-that is, its exports were less than its imports. Mercantilist policies are still politically attractive to some firms and their workers, as mercantilism benefits certain members of society. Modern supporters of these policies are known as neo-mercantilists, or protectionists (Mahoney, Trigg, Griffin, & Pustay, 1998). The mercantilists were a group of economists who preceded Adam Smith. They judged the success of trade by the size of the trade balance (Lipsey, & Chrystal, 1996).

The study of mercantilism by historians of economic theory demonstrates that from about 1660 to 1776 the quantity and quality of economic analysis increased. The improvement in the quality of economic analysis during the later part of the mercantilistic era was so pronounced that the period has been characterized as a transitional time containing the origins of scientific economics. Possibly the most significant accomplishment of the later mercantilists was the explicit recognition of the possibility of analyzing the economy. This development represented a transfer to the social sciences of attitudes then prevalent in the physical sciences. It reached its full fruition after the time of Isaac Newton (1642-1727), and its impact is still felt today. Many mercantilists saw a highly mechanical causality in the economy and believed that if one understood the rules of this causality, one could control the economy. It followed that legislation, if wisely enacted, could positively influence the course of economic events and that economic analysis would indicate what forms of government intervention would affect a given end. Mercantilists realized, however, that government interference must not be haphazard or complicate basic economic truths such as the law of supply and demand. Some of them correctly deduced, for example, that price ceilings set below equilibrium prices lead to excess demand and shortages. The later mercantilists frequently applied the concepts of economic man and the profit motive in stimulating economic activity. Governments, they said, cannot change the basic nature of human beings, particularly their egoistic drives. The politician takes these factors as given and

attempts to create a set of laws and institutions that will channel these drives so as to increase the power and prosperity of the nation.

Many of the later mercantilists became aware of the serious analytical errors of their predecessors. They recognized, for example, that specie is not a measure of the wealth of a nation, that it was not possible for all nations to have a favourable balance of trade, that no one country could maintain a favourable balance of trade over the long run, that trade can be mutually beneficial to nations, and that advantages will accrue to nations that practice specialization and division of labour. An increasing number of writers recommended a reduction in the amount of government intervention. Thus, the literature included statements of incipient classical liberalism.

The mercantilists made useful contributions to economic theory, the most important of which was their recognition that the economy could be formally studied. They were the first model builders in economics; because economic theory is based on the abstract, model-building process, it is reasonable to regard the mercantilists and the physiocrats as the first economic theorists. The mercantilists achieved the first tentative insights into the role of money in determining the general level of prices and into the effects of foreign trade balances on domestic economic activity.

As of 2010, the word "mercantilism" remains a pejorative term, often used to attack various forms of protectionism. The similarities between Keynesianism, and its successor ideas, with mercantilism have sometimes led critics to call them neo-mercantilism. Indeed, Paul Samuelson, writing within a Keynesian framework, defended mercantilism, writing: "With employment less than full and Net National Product suboptimal, all the debunked mercantilist arguments turn out to be valid."

Some other systems that do copy several mercantilist policies, such as Japan's economic system, are also sometimes called neo-mercantilist. In an essay appearing in the 14 May 2007 issue of *Newsweek*, business columnist Robert J. Samuelson argued that China was pursuing an essentially mercantilist trade policy that threatened to undermine the post-World War II international economic structure. All these suggest that mercantilism has some grounds of validity and practice in modern times.

CONCLUSION

Major Tenets Of the Mercantilist School

To summarize the whole idea of mercantilism, the main principles of the school are as follows

Gold and silver were the most desirable form of wealth. Mercantilists tended to equate the wealth of a nation with the amount of gold or silver bullion it possessed. All of the valued bullion as the way to achieve power and riches such that even at war, nations would export goods to their enemy as long as products were paid for in gold.

Nationalism. All the countries could not simultaneously export more than they imported. Therefore, only powerful nations could could capture and hold colonies, dominate trade routes, win wars against rivals, and compete successfully in international trade. Mercantilist nationalism quite naturally led to militarism.

Duty- free importation of raw materials that could not be produced domestically, protection for manufactured goods and raw materials that could be produced domestically, and export restriction on raw materials. The interest of the merchants took precedence over those of the domestic consumer. Merchants received inflows of gold in return for their exports, while the restrictions on imports reduced the availability of goods for consumption at home. Prohibition

against the outward movement of raw materials helped keep the prices of the finished exports low.

Opposition to internal tolls, taxes, and other restrictions on the movement of goods. Mercantilist writers and practitioners recognized that tools and taxes could throttle business enterprise and drive up the prices of a country's exports. It is important to point out however, that mercantilists did not favour free internal trade in the sense of allowing people to engage in any trade that they wished. On the contrary, mercantilists preferred monopoly grants and exclusive trading privileges whenever they could acquire them.

Strong central government. A strong central government was needed to promote mercantilist goals. The government granted monopoly privileges to companies engaged in foreign trade. It restricted free entry into business at home to limit competition. Agriculture, mining and industry were promoted with subsidies from the government and protected from imports via tariffs. Furthermore, the government closely regulated the methods of production and the quality of goods so that the country would not gain a bad reputation for its products in foreign markets, thereby hampering export. A strong national government was therefore required to ensure uniform national regulation. Central governments were also necessary to achieve the goals discussed previously: nationalism, protectionism, colonialism, and internal trade unhampered by tools and excessive taxes.

Importance of a large, hard-working population. Not only would a sizeable, industrious population provide an abundance of soldiers and sailors ready to fight for the glory and the wealth of the nation, but also it would keep labour supply high and wages therefore low. These low wages would enable lower prices on exports, thereby increasing the inflow of gold and reduce idleness and promote greater participation in the labour force.

Whom did the mercantilist school benefit or seek to benefit?

The doctrine benefited the merchant capitalists, the kings and the powerful government officials. It especially benefited those who were most powerful and entrenched and had the most favoured monopolies and privileges. Some historians of economic thought suggest that mercantilism can best be understood as an extreme example of rent seeking behaviour. Rent seeking activities are simply attempts by private parties to increase their profits by securing favourable laws and regulations from government. Such laws took the form of grants of monopoly status, prohibitions against imports, and regulations that made it difficult for new producers and merchants to compete successfully against the established ones. According to this line of reasoning, government officials in power were willing to make these laws and regulations, to dispense economic rent, as a way to secure benefits for themselves and for the royalty at those whose pleasure the served. Economic rent is defined as profits beyond those that would be just necessary to keep the merchant capitalists engaged in their present activities, that is, just sufficient to compensate them for their opportunity costs.

How was the mercantilist school valid, useful, or correct in its time

the argument for bullionism, although exaggerated, made some sense in a period of transition between the predominantly self sufficient economy of the Middle Ages and the money and credit economy of modern times. The rapid growth of commerce required more money in circulation and banking was insufficiently developed to produce it. Wars were fought on a pay-as-you-go basis, and the bullion provided a reserve that could be used to hire and maintain soldiers, build ships , buy allies and bribe enemies.

Mercantilists were also aware that an influx in precious metals made tax collection easier. They knew that prices would rise, or at least would not fall if the quantity of money increased as trade expanded. Not only was the volume of output expanding, but also the self sufficient household was being drawn into the market economy. More money was therefore needed to buy and sell the same volume of output. Some mercantilists were also aware that increases in the amount of gold and silver in circulation reduced interest rates and promoted business.

Which tenet of the mercantilist school became lasting contributions?

The mercantilist made a lasting contribution to economics by emphasizing the importance of international trade. They also developed the economic and accounting notion termed balance of payments between a nation and the remainder of the world.

They did indirectly contribute to economics also. First, they permanently influenced the attitudes of merchants. The medieval aristocracy had classed people engage in business as contemptible second class citizens who were immersed in the muck of merchandising and the exchange of money. The mercantilists gave respectability and importance to merchants by arguing that when they are activities were properly channelled by government, merchants enriched not only themselves but also the kings and the kingdom. The landed aristocrats eventually began to participate in business ventures without losing their status and dignity.

Secondly, they promoted nationalism, a force that is very much alive today. Central government regulation is necessary when uniform weights, measures, coinage, and laws are needed; when production and trade have not yet developed sufficiently to permit reliance on competition to provide consumers a wide choice of goods; and when the financial risks of trade are so high that monopoly privileges are necessary to induce more risk taking than would otherwise occur.

Evaluation Of Mercantilism

Generally, mercantilism is not a scientific system of thought. A scientific stance exist when the body of knowledge is organised, empirically tested and conclusions are not modified to suit certain objectives. Unfortunately, mercantilist writings do not pass this test. What unifies the writings of mercantilist is they emphasize on a large and densely population, abundance of money and foreign trade with a surplus balance.

The lack of scientific treatment can be ascribed to a number of factors. The science of economics was yet in a state of formation. Each mercantilist was covering only a limited number of problems and his treatment was often coloured by both inadequate understanding of the economic phenomenon and the particular policy prescriptions which he wanted to make. For example mercantilists have been accused of not taking a global view of their central doctrine of balance of trade. It is argued that all countries cannot attain a surplus balance of trade at the same time. This is true but the mercantilists were not interested in viewing this issue globally.

Also, an imperfect understanding of economic phenomena led to some contradictory views and policy prescriptions. For instance, they were not clear about the relationship between money, prices and demand. They had rudimentary idea of the quantity theory of money and were finding that increased quantity of money led to higher prices. Ordinarily, this should have led them to argue that higher prices would lower exports and increase imports, but instead they wanted more money and higher prices so that exports could be sold at favourable prices. Thus in spite of the fact that they were intimately concerned with the foreign trade, money stocks and prices and exchange rates, they failed to see a proper relationship.

Nevertheless, it should be noted that mercantilism was not an academic system and therefore we should not expect a pure scientific approach in its treatment. It was bound to exhibit an imperfect understanding of economic phenomena and contradictions. But it had an immense practical value and quite a few lessons may be learnt from it even now. It focused our attention at some

important economic issues of a developing economy. Also, mercantilism directed our attention to the problems of money and finance which no modern economy can sustain itself without a developed and healthy monetary and financial structure.